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First National City Bank Monthly Letter Business and Economic Conditions

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General Business Conditions

THE business improvement has carried further during March. According to preliminary evidence, those who consider industrial production the most important single business index can now say that recovery has been achieved, for March output appears to have regained the pre-recession peak of 146 (1947-49 = 100). In February the index was 144. Moreover, the rise is backed by expectation of further advances, by increased unfilled orders, by solidly favorable trade figures, and by a good state of confidence. With steel mills heavily sold ahead, industrial output should reach new high ground in the second quarter. The high level of purchasing power, resulting from record personal income and relatively stable consumer prices, is reflected in excellent

Easter business. The growing confidence of businessmen and the improving profits picture in recent months show in plans for modest increases in plant and equipment outlays during 1959.

There is continuous debate in the country over the level of unemployment, the rate of economic growth, inflation, government policies, and union demands in forthcoming wage negotiations. But with all the conflicting influences and resulting uncertainties, confidence in the continuation of the upswing, even though at a moderate and perhaps irregular pace, seems general.

An illustration of the magnitude of the overall rise anticipated for 1959 is found in recent estimates by the Joint Economic Committee of the Congress, based on discussion with both government and private authorities. The gross national product (the estimated money value of all goods and services produced in the country) is expected to total \$473 billion this year, compared with \$438 billion last year and an annual rate of \$453 billion in the fourth quarter of 1958. The upward movement brought an estimated \$11 billion increase in the first quarter, to an annual rate of \$464 billion.

Against this background of over-all progress, irregularities still show. While steel mills are striving to bring marginal facilities into production to meet demand, crude petroleum producers in Texas face a cutback in allowable production. Within industries, earnings reports are mixed. While fourth quarter 1958 earnings generally rebounded sharply, one out of three reporting manufacturing companies had lower earnings than in the third quarter. The recovery has also had an uneven impact on regions and communities, leaving pockets of unemployment which continue to be a matter of concern.

Rise in Inventories

Although, with a few exceptions such as steel, buying continues cautious, inventory accumu-

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Supplement

With this issue is published a supplement containing a communication from George Meany, President, AFL-CIO, concerning an article in our August 1958 Monthly Letter entitled "Union Power and the Public Interest", and a reprint of that article.

lation by manufacturers is now under way. This marks the final stage of the shift in business inventory policies which began last spring with the slowing of the rate of liquidation. By the end of 1958, slack buying had, in some lines, cut inventories to uncomfortably low levels. Rising sales volume has brought home the need for higher stocks, and forward commitments have been extended. Factory inventories on January 31 were reported to be up \$284 million since the start of the year, on a seasonally adjusted basis.

In steel, where most of this increase occurred, consuming industries are covering against the possibilities of a steel strike and higher prices. In late March, President Eisenhower expressed the strong hope that steel management and labor could settle their wage negotiations in such a way "that there be no advancement in the price of the commodity the public has to pay." Nevertheless, buyers, familiar with history, are rapidly filling steel companies' order books through mid-year for all except a few types of steel products.

The swollen demand for steel pushed ingot production in March to the highest tonnage for any month in the industry's history. In the last half of March, output was 93 per cent of capacity—a rate equivalent to 137 million tons a year. The inventory build-up is expected to continue into June, holding operations above 90 per cent of capacity. It is difficult to judge how fast steel is accumulating in the hands of consumers and warehouses, but an educated guess would be that at least 15 per cent of the record 65 million ingot tons expected to be produced in the first half of 1959 will be added to stocks. Strike or no strike, demand in the second half can hardly be anywhere near so great.

The current steel wage contract, which expires June 30, has provided uninterrupted operations for nearly three years. Some previous post-war settlements have been arranged peacefully and others only after strikes ranging from 12 hours in 1955 to nearly two months in 1952. Steel users, trying to protect themselves against the possibility of a shutdown, appear to be planning to build stocks adequate for four to six weeks. Thus, even a month-long strike might exercise only a mild restraint on the nation's over-all activity.

Stocks of auto dealers reached about 850,000 new cars at the end of March, slightly more than the industry had planned to have on hand for its spring market. New domestic passenger car sales in the second 10 days of March were at the highest rate for any mid-month period since June 1957. Thus far this year, car sales have averaged

about 23 per cent ahead of 1958 and the gap has been widening. Registrations of imported cars have held fairly steady since last September between 35,000 and 40,000 a month. Combined imported and domestic car sales in the first quarter of this year are estimated at over 1.4 million, compared with 1.1 million in the 1958 quarter and about 1.5 million in 1957.

Plant and Equipment Outlays

Businessmen are planning to spend about 4 per cent more on plant and equipment in 1959 than in 1958, according to a survey made in February by the Securities and Exchange Commission and the U.S. Department of Commerce. It is now confirmed that total business capital spending (seasonally adjusted) reached bottom in the third quarter of 1958, although in manufacturing such outlays did not reach their low until the fourth quarter.

Over all, capital spending last year fell to \$30.5 billion from \$37.0 billion in 1957, an actual drop of 17 per cent compared with the 13 per cent decline anticipated in the 1958 survey. The upturn now under way is expected to be gradual, carrying the scheduled 1959 total to \$31.8 billion, still 14 per cent short of the 1957 record. This year, only the airlines, making heavy outlays for jet passenger planes, currently expect to surpass their 1957 totals. However, several industries expect to increase capital spending 10 per cent or more, including automobiles, electrical machinery, textiles, and petroleum. On the other hand, further declines are anticipated in primary metals and mining.

The preliminary figures for the first quarter showed that businessmen boosted their spending plans above what they had anticipated three months earlier; during most of the preceding business upswings each successive survey revealed further increases in capital outlays over earlier estimates. Now that outlays are rising again, it is not unlikely that this experience will be repeated.

What to Do About Unemployment

The continuance of a 4.7 million estimated level of unemployment in February has been the subject of a good deal of discussion. Much of this ignores the fact that unemployment is normally swollen during severe winter weather. We had correspondingly high unemployment figures early in 1950, emerging from the 1949 business recession. Nevertheless, the figure is higher than "normal" or "frictional" unemployment, and a proper cause of concern.

What to do about it is the question. The most effective, if least dramatic, approach would be to rely on seasonal improvement (for example, on farms and in construction work), business gains and the effort of people to produce jobs for themselves. In the end the momentum of the upswing is likely to prove the chief factor in reducing unemployment, and that in itself suggests that the best solution is to follow policies that will preserve business confidence, encourage investment, and keep the recovery moving.

Another approach, being urged in Washington, is to use increased federal spending and easy money to create more jobs. These were the stimulants applied with great energy last year to help arrest the recession. The trouble with such policies is that they may be very costly in other respects. They lead to the waste and extravagance of "made work." To persist in them when recovery is manifestly under way involves the risk of creating an unsustainable burst of activity, as was the experience in 1955 when the easy money spigot was left open too long. The President wishes to hold back expenditures and allow rising revenues growing out of business recovery to swing the budget back into balance. This is the sensible course for fiscal policy dedicated to economic stability.

A well-known economics professor in a leading university has recently revived the shopworn argument that the way to increase employment is to raise wages of people already employed. This ignores the employer's problem of financing higher wage costs, the impetus given to price increases, and the likelihood that, when wage and price adjustments have gone full circle, the end result will be to shave some more cents off the dollar. The consequence may be more unemployment—if consumers resist higher prices, turn to foreign sources of supply, or simply refuse to spend. Relatively high-priced labor may find that jobs have moved elsewhere—as in the case of northern textile workers—or that they have been replaced by machines—as in coal mining. Workmen, just like merchants and manufacturers, can price themselves out of the market.

This is the basic objection to the AFL-CIO's suggestion that the minimum wage be boosted from \$1 to \$1.25 an hour. Secretary of Labor Mitchell noted that such a raise "would do more harm than good" since an extensive survey indicated that: "A further increase in the minimum at this time would involve the risk of substantially curtailing employment or earning power in the low wage industries." If employers have more payroll money to spend it will be better

spent offering more jobs than increasing pay to existing employees.

Corporate Earnings in 1958

Annual reports for the year 1958 now available for 3,574 companies show combined net income after taxes of \$17.5 billion, a decrease of 10 per cent from the preceding year. This is somewhat better than our preliminary summary of some 2,200 companies given last month, which indicated a 12 per cent decline. There were lower net income totals in the fields of manufacturing, mining, and transportation, increases in public utilities and finance, and little change in trade.

Results for the year were helped greatly, as pointed out in this *Letter* last month, by the pickup in sales and the rebound in earnings toward the end of the year. For a sampling of manufacturers' figures, fourth quarter earnings were 33 per cent above the third quarter and 13 per cent above the final quarter of 1957.

Last year's net income after taxes of the reporting corporations, other than those in banking and finance, represented an over-all average net profit margin of 5.5 per cent on total sales or revenues. This was narrower than the 6.1 per cent average margin realized in 1957 and also below the 6.4 average for the postwar decade 1946-55. The following summary shows the uneven changes among the main divisions of incorporated business, while the table on the next page gives the totals by major industry groups, with average percentage profit margins and rates of return on book net assets.

Net Income of Leading Corporations for the Years
1957 and 1958

(In Millions of Dollars)

No. of Cos.	Industry Divisions	Net Income After Taxes		Per Cent Change	Per Cent Margin on Sales	
		1957	1958		1957	1958
1,852	Manufacturing	\$12,967	\$10,643	-18	5.9	5.3
88	Mining	186	142	-24	7.6	6.9
232	Trade (ret. & wh.)	785	778	-1	2.5	2.5
224	Transportation	908	758	-17	6.1	5.6
279	Public utilities	2,703	2,973	+10	13.3	13.5
115	Amuse., service	204	181	-11	4.6	4.4
814	Banks and finance	1,830	2,085	+14	—	—
3,574	Total	\$19,584	\$17,556	-10	6.1	5.5

Reflecting the influence of the general business recession last year, it will be seen from the detailed summary that 42 of the 65 major industry groups experienced lower net income.

Upon the book net assets (also called "net worth" or "capital and surplus" or "shareholders' equity"), which aggregated \$195 billion at the beginning of 1958, the year's net income represented an average return of 9.0 per cent. Only 11 of the major groups had higher rates of return last year than in 1957, against 54 groups with lower rates.

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1957 AND 1958

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes		Per Cent Change	Book Net Assets Jan. 1-a		% Return on Net Assets-a		% Margin on Sales-b	
		1957	1958		1957	1958	1957	1958	1957	1958
20	Baking	\$ 65,677	\$ 63,759	-3	\$ 524,192	\$ 555,004	12.5	11.5	3.4	3.2
14	Dairy products	102,497	107,138	+5	863,916	909,916	11.9	11.8	2.5	2.6
18	Meat packing	37,384	39,714	+6	832,141	896,144	4.2	4.4	0.5	0.5
21	Sugar	54,800	39,010	-29	609,047	635,172	9.0	6.1	4.9	3.5
88	Other food products	352,371	372,500	+6	3,068,411	3,271,578	11.5	11.4	3.9	4.2
14	Soft drinks	48,977	50,297	+3	338,711	358,331	14.5	14.0	*	*
20	Brewing	25,170	27,233	+8	339,570	349,738	7.4	7.8	2.5	3.0
11	Distilling	89,555	90,165	+1	1,246,817	1,292,614	7.2	7.0	3.6	3.6
16	Tobacco products	191,057	229,770	+20	1,506,127	1,672,521	12.7	14.6	5.2	5.7
72	Textile products	149,498	126,706	-15	2,903,526	2,959,216	5.1	4.3	3.1	2.7
46	Clothing and apparel	27,723	25,878	-7	414,586	427,821	6.7	6.0	2.9	2.7
24	Shoes, leather, etc.	46,359	38,216	-16	420,022	438,215	10.8	8.7	3.4	3.0
24	Tires, rubber products	224,731	206,931	-8	1,818,666	1,966,895	12.4	10.5	4.4	4.1
26	Lumber	105,333	105,487	+1	1,114,397	1,165,771	9.5	9.0	6.9	6.7
17	Furniture, wood products	20,698	21,758	+5	265,587	293,239	7.8	7.4	4.4	3.5
71	Paper and allied products	373,100	343,426	-9	3,552,535	3,764,153	10.6	9.1	6.9	6.2
44	Printing and publishing	80,430	73,175	-9	575,767	640,940	14.0	11.4	4.9	4.3
72	Chemical products	966,764	815,125	-16	6,912,388	7,360,354	14.0	11.1	8.5	7.2
27	Drugs and medicines	287,072	296,472	+3	1,209,366	1,353,544	23.7	21.9	11.7	11.4
19	Soap, cosmetics, etc.	120,608	129,867	+7	687,688	822,749	17.5	15.7	5.5	5.4
22	Paint and varnish	104,562	93,072	-11	661,440	729,506	15.8	12.8	7.0	6.4
121	Petroleum prod. and refining	3,267,729	2,697,483	-21	23,920,390	25,400,052	13.7	10.2	9.7	8.4
80	Cement	118,778	132,961	+12	738,354	831,221	16.1	16.0	15.5	16.1
17	Glass products	164,553	137,103	-17	1,055,905	1,150,487	15.6	11.9	8.1	7.1
58	Other stone, clay products	210,896	197,789	-6	1,595,941	1,709,580	13.2	11.6	8.3	7.9
49	Iron and steel	1,151,580	790,822	-31	8,710,601	9,614,155	13.2	8.2	7.4	6.3
11	Agricultural implements	129,949	142,217	+9	1,886,690	1,940,249	6.9	7.8	4.1	4.6
81	Building, heat, plumb., equip.	140,760	122,802	-13	1,500,058	1,617,674	9.4	7.6	3.9	3.4
112	Electrical equip., radio & tv.	650,232	619,092	-5	4,671,518	5,078,462	13.9	12.2	4.2	4.2
43	Hardware and tools	63,437	39,314	-38	585,858	637,039	10.8	6.2	5.9	4.0
38	Household appliances	63,010	60,595	-4	668,163	701,146	9.6	8.6	4.0	3.9
153	Machinery	358,506	229,500	-36	2,626,898	2,864,746	13.7	8.0	5.7	4.3
26	Office equipment	165,226	177,795	+8	920,242	1,265,318	18.0	14.1	6.4	6.6
44	Nonferrous metals	418,108	304,763	-26	4,252,148	4,576,569	9.7	6.7	7.9	6.4
76	Instruments, photo, goods, etc.	231,703	207,223	-11	1,539,500	1,700,136	15.1	12.2	6.5	5.7
111	Other metal products	293,525	240,367	-18	2,451,253	2,634,445	12.0	9.1	4.1	4.0
15	Autos and trucks	1,259,395	735,049	-42	7,694,398	8,320,643	16.4	8.8	5.7	4.2
60	Automobile parts	170,178	101,557	-40	1,403,741	1,487,674	12.1	6.8	4.9	3.6
22	Railway equipment	105,381	62,962	-40	1,036,218	1,089,003	10.2	5.8	4.4	3.5
39	Aircraft and parts	370,673	305,828	-18	1,854,472	2,103,671	20.0	14.5	3.0	2.6
80	Misc. manufacturing	159,939	143,656	-10	1,562,691	1,654,277	10.2	8.7	4.0	3.8
1,852	Total manufacturing	12,967,169	10,643,377	-18	100,580,885	108,140,003	12.9	9.8	5.9	5.2
24	Coal mining - c	82,142	57,714	-30	905,849	955,751	9.1	6.0	6.3	5.4
26	Metal mining - c	67,742	53,648	-21	789,731	821,642	8.6	6.5	6.1	6.2
8	Other mining, quarrying - c	36,385	80,739	+16	236,106	250,788	15.4	12.3	19.2	19.5
58	Total mining, quarrying	186,269	142,001	-24	1,931,736	2,028,131	9.6	7.0	7.6	6.9
85	Chain stores - food	152,022	160,375	+6	956,016	1,056,724	15.9	15.2	1.4	1.4
58	Chain stores - variety, etc.	186,433	133,028	-2	1,472,669	1,528,445	9.3	8.7	3.1	2.8
60	Department and specialty	201,930	190,317	-6	2,024,292	2,096,960	10.0	9.1	2.8	2.6
6	Mail order	198,196	196,214	-1	1,852,055	1,929,074	10.7	10.2	4.0	3.9
73	Wholesale and misc.	96,403	92,742	-4	932,831	976,106	10.3	9.5	1.9	2.0
232	Total trade	784,984	773,171	-2	7,237,913	7,587,309	10.8	10.2	2.5	2.3
113	Class 1 railroads - d	740,295	601,534	-19	16,162,140	16,029,413	4.6	3.8	7.0	6.3
26	Traction and bus	22,652	18,171	-20	422,215	411,589	5.4	4.4	3.4	1.0
13	Shipping	65,254	50,854	-22	581,496	636,359	11.2	8.0	7.9	9.2
20	Air transport	34,747	45,133	+30	691,942	767,202	5.0	5.9	2.2	2.7
52	Misc. transportation	45,316	42,105	-7	402,162	437,066	11.8	9.6	5.0	4.0
224	Total transportation	908,264	757,797	-17	18,259,955	18,281,629	5.0	4.1	6.2	5.6
246	Electric power, gas, etc. - d	1,744,402	1,872,481	+7	18,320,146	18,784,704	9.5	10.0	13.4	13.4
33	Telephone and telegraph - d	958,625	1,100,946	+15	10,726,495	11,422,799	8.9	9.6	13.2	13.8
279	Total public utilities	2,703,027	2,973,427	+10	29,046,641	30,207,508	9.8	9.8	13.3	13.6
22	Amusements	36,668	28,787	-21	720,366	708,629	5.1	4.1	3.1	2.2
32	Restaurant and hotel	12,697	11,976	-6	155,342	163,486	8.2	7.3	3.3	2.6
39	Other business services	114,765	101,638	-11	612,867	691,208	18.7	14.7	7.5	6.0
22	Construction	40,263	38,829	-4	220,808	260,138	18.2	14.9	3.4	3.7
115	Total amusements, services, etc.	204,393	181,225	-11	1,709,333	1,823,461	12.0	9.9	4.8	3.9
392	Commercial banks	970,093	1,081,314	+12	9,623,309	10,361,252	10.1	10.4	—	—
63	Fire and casualty insurance	76,392	192,640	+25	3,731,870	3,462,394	2.0	5.6	—	—
218	Investment trusts - e	527,661	545,640	+3	11,337,514	11,159,266	4.7	4.9	—	—
80	Real estate	246,064	253,517	+3	1,564,068	1,724,375	15.7	14.7	—	—
61	Real estate	9,739	10,957	+13	169,268	178,589	5.8	6.1	—	—
814	Total finance	1,829,949	2,084,568	+14	26,426,029	26,835,876	6.9	7.8	—	—
3,574	Grand total	\$19,584,055	\$17,555,566	-10	\$185,192,542	\$194,953,962	10.6	9.0	6.1	5.5

a—Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures in most cases exclude capital gains or losses on investments. *—Not computed because of limited number of sales figures available for the group. †—Increases or decreases of under 1% or over 100% not shown.

The 9.0 per cent return on book net assets was the poorest result since 1945—less than in the previous business recessions of 1949 and 1954—indicating a failure of profits to keep pace with enlargement of invested capital. Such capital, derived to a major extent from retained earnings, was used mainly to finance the continuing heavy outlays for expansion and modernization of plant and equipment, plus building up working capital. This great expansion of property investment resulted, in turn, in heavier charges against operating earnings to provide for depreciation, and thus lowered net income. On the other hand, larger and newer plants ordinarily bring about an increase in efficiency and a lowering of operating costs, giving a plus factor in net income.

In using rate of return figures as a measure of earnings it must be kept in mind, of course, that the book net assets taken as the base represent merely the balance sheet amounts, which in the case of most physical property are based on historical costs, less accrued depreciation, and thus are well below present-day replacement costs. In addition, the book valuations may be far below market in the case of such other assets as inventories, investments, natural resources, patents, trade marks, brand names, goodwill, etc. Thus, the rates of earnings as computed on book values are usually much higher than if they could be figured on replacement costs of all assets.

Trends in Manufacturing

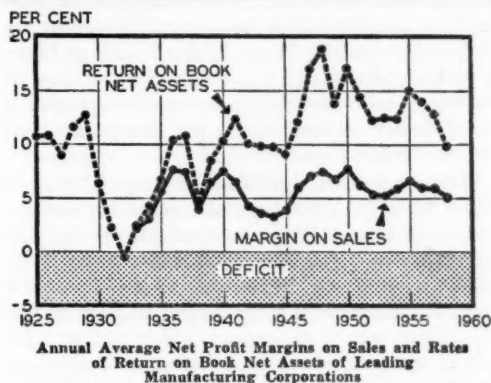
In the manufacturing industries, which in our tabulation make up more than half of the total in numbers and dollar amounts, the reports now available from 1,852 companies confirm the trends indicated by our preliminary summary last month, with combined net income after taxes down 18 per cent. Although larger dollar sales were billed by 40 per cent of the reporting companies, increases in net income were realized by only 36 per cent.

In 1957 there were deficits reported by 121 manufacturers totaling \$93 million, while in 1958 the number of deficits rose to 197 with losses of \$146 million.

A comparison of manufacturing earnings in 1958 with the trend over a longer period is shown in the accompanying chart based on our previous annual tabulations.

In 1958 the average net profit margin of these manufacturing companies was 5.2 per cent on sales and other income, against 5.9 in 1957. Last year's margin was also below the 6.5 per cent average for the postwar decade 1946-55.

Rate of return on book net assets or shareholders' equity was 9.8 per cent, against 12.9 in 1957.



As will be seen from the chart, last year's return was the lowest since 1945.

During the years since 1945, the tremendous capital investment by American industry, put on the books at rising price levels, has both broadened the capital base and helped to narrow the discrepancy between book valuations and real values, although there is always a considerable lag. While growth in recent years has tended to make rates of return more realistic and useful, they still are not a strictly accurate measure of earnings between different industries, or even between companies in the same industry, because of the many cases in which the available figures are not closely comparable.

Financing the Deficits

Expenditures of government this year are surpassing any previous experience, running upwards of \$130 billion for cash outlays of Federal, State, and local governments combined. Raising all these funds imposes heavy financial burdens on taxpayers as well as on the markets for borrowed money. There are symptoms of taxpayer discontent with the mounting tax burden. The money and capital markets, on their part, have staggered at times under the weight of government security offerings.

It seems clear that, while people like government spending programs in particular, they are not so keen about the total costs to which they add. What the taxpayers, and investors too, have been trying to tell the legislatures is that there are limits on what governments should attempt to spend. Curbing expenditures is the only way government can hold within bounds of tolerance its demands for tax revenues and borrowed money. While Congress persists in a policy of tacking on additional items, President Eisenhower's call for retrenchment has relieved immediate anxieties over further increases in

federal tax rates and such oversupplies of government securities as to destroy confidence in the dollar. Meanwhile, State and local taxes go higher and higher though Governors of a number of the States are scrutinizing expenditure proposals more closely to limit needs for more taxes and heavier borrowings.

States and municipalities, offering obligations which have the advantage of income tax exemption, have been selling new securities so far this year in a volume averaging more than \$700 million a month. Of greater magnitude have been Federal Government borrowings, to finance the \$13 billion record peacetime deficit and to take care of obligations reaching maturity. Beginning last August, the U.S. Treasury has been in the market to borrow money in some dimensions every single month.

Money market experts quite generally expect firming interest rates later in the year. This would be the natural tendency under conditions of improving business, though curtailment of federal expenditures and borrowings can prevent acute stringency. In a press conference on February 18, the President indicated that, while he hoped the situation would not arise, he would ask Congress to raise the 4½ per cent legal rate limit if necessary to find buyers for U.S. bonds.

Stabilization of Bonds

There is little question but that the Treasury would have to pay more than 4½ per cent on bonds if the attempt were made to finance the bulk of the huge deficit at long term. But some amounts of long-term money have been available within the existing limit. After bond speculation collapsed last summer, and Treasury bonds dropped to a point that raised yields to 4 per cent, buying appeared which arrested further price decline. As was true also in 1957, 4 per cent on U.S. securities is a figure that commands broadened investor interest. In January the Treasury took advantage of this demand to sell \$884 million 4 per cent bonds at a price of 99, to yield the buyer 4.07 per cent. In March the Treasury placed an additional \$619 million of the existing 4 per cent bonds of 1969, originally issued in 1957.

Meanwhile, tax-exempt State and local government bonds, which touched their lowest prices in September, strengthened. The *Bond Buyer's* average of yields on 20 municipal bonds, at a high above 3½ per cent early in September, was nearer 3½ per cent in March. New corporate bond issues, in reduced supply these past six months, have been well received where underwriters have not cut offered yields too fine. The average yield on new issues of high-grade corporates, adjusted

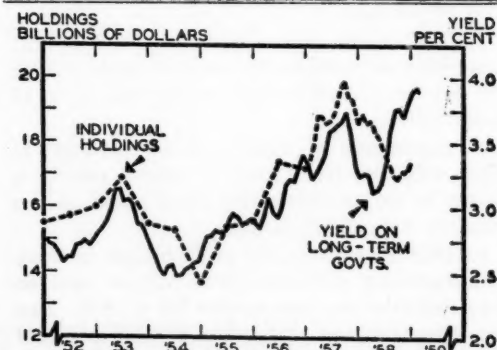
to a Aaa basis, rose from 3.61 per cent in June 1958, near the bottom of the recession, to 4.58 per cent in September but has slipped off to around 4.30 per cent in recent months.

The President's insistence on counteracting inflationary pressures and rebalancing the budget has been a vital help to the salability of bonds. It helped convince many people that the third quarter price declines had gone too far, to a point where the bond market was technically oversold and ripe for some recovery.

Nevertheless, the strength of bonds has been remarkable, particularly in the face of continuing heavy demands for mortgage money. Real estate mortgage indebtedness is rising at an average rate of \$1¼ billion a month, the greater part against new home construction.

The essential explanation of the ability of the market to supply mortgage funds in such volume, as well as to absorb new bond issues, has been the flow of savings channeled into banks, savings and loan associations, insurance companies, and pension funds. This savings flow, fortified during the recession, has been sufficient—at a time of reduced offerings of corporate bonds—to create some surpluses of institutional funds for investment in government bonds.

Meanwhile, individuals have displayed some interest in marketable U.S. bonds paying 4 per cent as well as in tax-exempt municipals. The effectiveness of improved rates in stimulating demand for U.S. securities is often disparaged. The fact is that, given some time to respond, individuals have tended to buy more marketable U.S. securities when their prices have been low and yields improved and to cut back holdings when prices have risen and yields have been depressed. This relationship is brought out in the following chart. While the last Treasury estimate on individual holdings is for December,



U.S. Government Securities Other than Savings Bonds Held by Individuals and Yield on Long-term U.S. Bonds, 1952-58 (Bond yields are monthly averages. Holdings are for month ends: June and December 1952-56, monthly 1957-58.)

there can be little doubt but that a renewed rise is now under way, assisted by 4 per cent rates on new Treasury offerings.

Lull in Corporate Financing

The stabilization of the bond market during the past six months has coincided with a lull in business financing. Corporate bond offerings averaged \$830 million a month during 1957 when capital expenditures reached their peak; they then rose to \$880 million a month during the first nine months of 1958 as industry took advantage of easy money conditions to complete financing of capital programs and strengthen cash positions. Beginning with October 1958, corporate bond issues have dropped closer to \$500 million a month, reflecting the improvement in corporate cash positions stemming from inventory reduction, reduced capital outlays, and — since the second quarter of 1958 — better profits. Also reflecting this situation, business loan demands on the banks so far have been moderate. Indeed, corporations have been able to help finance the federal deficit by acquiring Treasury bills with their accumulating liquid resources.

In a way, the rise of common stock prices to record-high levels has given support to bonds. Stock yields have been driven far below prevailing bond yields to a point where they discount growth of dividends many years into the future. Under these conditions, conservatively-minded individual investors and pension fund trustees, who previously favored common stock investments for income, have become inclined to look upon bond investments more favorably. The maintenance of this attitude, of course, hangs upon the pursuit in Washington of fiscal policies that discourage fears of rampant inflation.

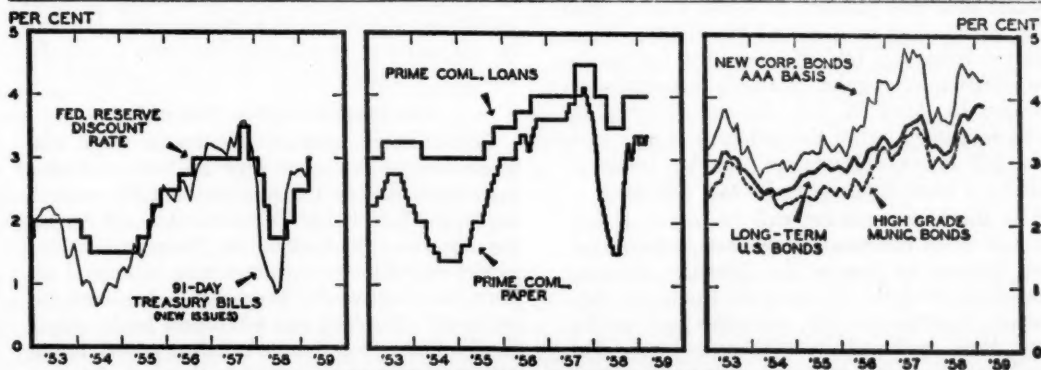
Discount Rate Advance

A further factor of strength in the bond market — though one of a rather artificial character

— was the abnormally wide spread that had developed between the Federal Reserve discount rate and available yields in the money and bond markets. At 2½ per cent until early March, the discount rate seemed an invitation to banks to carry more securities and get the money by borrowing from the Federal Reserve. In raising the rate to 3 per cent on March 6, the authorities apparently sought to discourage excessive participation by the banks in deficit financing, properly preferring to develop the market outside the banks albeit at higher money cost.

Some critics described the discount rate increase as a "tight-money dampener to economic recovery" and "a terrible and cruel thing." Yet money is not "tight" and Federal Reserve credit policy is better described as "neutral" rather than "restrictive." Although gross national product — the most inclusive measure of the nation's output — has pushed well ahead of its pre-recession peak, money rates and bond yields are generally below their 1957 highs. The major exception is the yield on long-term Treasury bonds; this reflects the size of the federal deficit and the demands of investors for rates of interest which offer compensation for expected inflation. For lack of stronger credit demands from business, banks have been lending increased sums to State and local governments, putting money into real estate mortgages at the fastest pace since 1955, and developing new credit facilities to serve consumers.

As the chart shows, the discount rate had been out of line with the market for at least six months. It is now in a more reasonable relationship, around the average level of Treasury bill yields, and 1 point below the banks' prime loan rate which in turn stands between commercial paper rates and new corporate bond offering rates. Under the circumstances, the discount rate advance had limited effect on money rates and



Money Rates and Bond Yields, Monthly, 1953-59

bond yields. It did, however, serve as a useful reminder of the need to maximize distribution of government securities outside the banks. This is a matter of keeping yields up to levels that invite nonbank buying interest and of persevering in the efforts to get government outlays under control.

Short-Term Treasury Financing

The Treasury so far has financed the bulk of its deficit at short term. The following table shows the maturity breakdown of marketable new securities sold for cash or issued in exchange for maturing obligations since the beginning of the present fiscal year on July 1, 1958.

Marketable Treasury Securities Issued,
July 1, 1958 - April 1, 1959
(In Billions of Dollars)

	Total Issued	—Maturing—			Amount Retired	Net Change
		1959- 1960	1961- 1963	After 1963		
Bills	\$11.8*	\$11.8*	\$—	\$—	\$—	\$+11.8*
Cert.	36.2	36.2	—	—	\$4.7	+ 1.5
Notes	11.8	3.9	7.9	—	5.8	+ 6.6
Bonds	1.5	—	—	1.5	7.6	- 6.1
Total	\$61.3	\$51.9	\$7.9	\$1.5	\$47.6	\$+13.7

*Represents sales of tax anticipation and special bills but only net additions to regular weekly issues.

The Treasury has been sailing with the wind so far in financing its deficit and placing greatly enlarged amounts of Treasury bills and other short-dated paper. U.S. business corporations, as explained earlier, have been generating cash for investment in the money market in anticipation of taxes coming due or other corporate needs. The rebound of money rates, occurring mainly in the third quarter of 1958, of course has given essential help; many holders of liquid funds simply will not bother to invest them if the return offered is low. In the case of foreign central banks, better rates provided an inducement to make short-term dollar investments as an alternative to purchasing gold from the U.S. stock.

In March, while also tapping the note and bond markets, the Treasury sold \$2.0 billion special bills due January 15, 1960, raising total bills outstanding to a record \$34 billion. Plans call for enlarging bill offerings still further by the creation of regular quarterly maturities on January 15, April 15, July 15, and October 15, to be redeemed out of the proceeds of new one-year bill issues. Heretofore, regular issues of bills have been confined to 91 and 182 days.

The short-term market will be in for a very real test when business corporations, which have been helping to finance the Treasury, become competitors with the Treasury for funds, dip into reserves invested in U.S. securities and at the same time seek additional bank loans. For broadened business recovery means inventory

accumulation and upturn in capital spending programs, both of which take more money. To make full-scale business recovery financially manageable, government will need to restrict its expenditures, step aside as a short-term borrower, and take greater resort to the market for long-term bonds.

This is the prescription for orderly money markets as it is also for economic stability. Economic and monetary stability go hand in hand, and together give the basis for orderly planning for progress.

How to Beat Inflation

There is an old political adage that runs, "if you can't lick 'em, jine 'em." This same philosophy seems to have spread into the financial arena as more people have come to believe in the inevitability of a dwindling dollar and have sought to shield themselves accordingly. Indeed, for many, the attitude is more than mere capitulation to the forces of inflation: it is a willingness to relax and enjoy it in the belief that they are clever enough to stay at least one whirl ahead in the spiral.

Growing inflation consciousness may seem unwarranted in view of official assurances that the cost of living will be "quite stable in the months ahead." Excess productive capacity, tightening up on business efficiency during the recession, and lower food prices should help to hold consumer prices in check over the near term.

Those who foresee long-pull inflation (interrupted now and then by periods of over-all price stability) base their belief on continuance of the cold war with its requirement of heavy defense spending, pressures of higher wages and taxes, government "full employment" policies, and generally the growth of the welfare state which emphasizes abundance of spending power.

There is no lack of evidence that fears of continued inflation have been influencing people's investment decisions. As a consequence, ironically, the worst price inflation has been in popular inflation hedges, such as the stock market.

Seeking Inflation "Shields"

Cost-of-living escalator clauses in wage contracts now cover over four million workers—more than double the number in 1955, according to the U.S. Labor Department. Last August the American Federation of Government Employees called for an escalator plan of annual adjustments that would "keep pay in line with living costs." Not long ago a business leader urged the Treasury to put out "inflation-proof" bonds with interest payments tied to the cost of living.

And a prominent economist suggested last month that Social Security checks be fitted with the same kind of escalator clauses.

Variable annuity plans have been developed under which assets would be invested in part in common stocks and annuity payments would vary with investment results, including dividends and changes in market value. Price supports for agriculture put farmers on a sort of escalator which increases their income as their costs go up.

In the money market, higher interest rates reflect among other things the demand of savers for better rates and the expectation that the dollar repaid tomorrow may be worth less than the dollar lent today. In the security markets, investor eagerness for stocks and lack of enthusiasm for fixed-income bonds stems in part from what a Federal Reserve Board Governor described not long ago as "almost psychotic fears of inflation in the future." And, finally, another sign of the times is the announcement last week that New Jersey will put some of its \$750 million pension funds in stocks. Previously, they could only be invested in bonds.

This heightened interest in inflation "shields" makes timely an analysis of their effectiveness as safeguards against the hardships and inequities brought on by a currency that steadily loses value.

Riding on Escalators

First, a word or two about escalator clauses in wage contracts, which link wages to the cost of living through the consumer price index.

While the buying power of the pay checks covered by such contracts might be preserved in the face of price rises, that of other items not covered—such as insurance policies, bank accounts, government savings bonds, etc.—would go down. And, of course, gains to those able to hedge through escalator arrangements are at the expense of everyone else in the community whose incomes do not go up and whose purchasing power is reduced by the higher prices.

Perhaps more fundamental, wage escalation weakens the resistance of workers to inflation, even giving them a sense of profiting from the process. Thus, they fail to support efforts to get at basic causes, including excessive government spending and deficits financed by "cheap" money. Inflation becomes "built-in." As higher wages and costs bring on higher prices, escalators give wages a further push. Then, as costs go up, prices rise again, bringing still another turn of the wage screw, and so on in a mounting spiral.

Dr. Paul McCracken, a former member of the President's Council of Economic Advisers,

summed up the impact of escalators in the *Michigan Business Review* of September 1955:

Price inflation is the way market forces endeavor to boil the surplus purchasing power out of the system. But if we set up escalator machinery by which as fast as the excess is removed it is promptly pumped back into the economy, the end result of a policy of slowly rising prices is certain to be prices rising not so slowly.

Gold, Art Treasures, and Gems

In foreign countries, gold, art treasures, and gems have been historic inflation hedges.

While people in this country cannot acquire gold at the statutory price of \$35 an ounce, they can buy it and have it stored in foreign countries such as England, Switzerland, and Canada. However, the buyer must pay storage charges, meantime receiving no return on his investment—unless, of course, the price of gold is raised. Even then there is the risk that tax or other impediments may bar a gain on such an increase.

Some people buy *objets d'art*. An auction in London not long ago, widely publicized in the press, provided examples of how the right paintings can show fantastic appreciation in value. A Van Gogh, reportedly bought 30 years ago for \$15,000, brought more than \$369,000.

But not all paintings prove so lucrative, as the *Saturday Review* pointed out in a December 6 article, "Does Rembrandt Pay Dividends?":

Consider some of the prices paid by the late Edward T. Stotesbury of Philadelphia, and those brought for the same pictures when sold at auction in 1944. George Romney's "Portrait of Captain Stables" declined from \$50,000 to \$5,500; Sir Thomas Lawrence's "The Hon. Caroline Upton," \$50,000 to \$9,000; . . . Hoppner's "The Tambourine Girl," \$300,000 to \$10,000; Romney's "The Vernon Children," \$225,000 to \$22,000.

Being able to select the right paintings requires a high degree of knowledge and skill—and even expert judgment may be proved wrong because of unpredictable changes in tastes and fashions.

Many people consider precious stones, rare coins, stamps, manuscripts, and antiques as good inflation hedges. Like paintings, these objects can give pleasures of possession. But they have uncertain markets and involve expenses to hold, insure, and resell. The job is one for the shrewd judge of values, not for the amateur.

How Investments Have Fared

As for the more mundane hedges—real estate, common stocks, commodities—the following table illustrates what happened from December 1948 to December 1958, the most recent decade for which figures are available.

During that period the consumer price index rose over 20 per cent, cutting the purchasing power of the dollar by about 17 per cent. The table shows changes in principal values over the decade, measured both in current dollars and in dollars of 1948 buying power.

Changes in the Nominal Value of Various Types of Investments, 1948-58, in Current Dollars and in Dollars of 1948 Purchasing Power

	Nominal Value Dec. 31 1948	Nominal Value Dec. 31 1958	% Chg. in Nominal Value	% Chg. in 1948 Dollars
Cash	\$100.00	\$100.00	—%	— 16.7%
Bonds				
U.S. Treasury 2½% of 12/15/57-72	100.15	85.20	— 14.9	— 29.1
New York City 4s of 10/1/50	124.25	102.00	— 17.9	— 31.6
State of New York 1½% of 3/15/55	86.53	66.80	— 22.3	— 35.7
Pfd. Stock - Average (Standard & Poor's)	169.50	151.70	— 10.5	— 25.4
Com. Stocks - Averages (Standard & Poor's)				
Railroads	13.92	34.39	+147.1	+105.3
Industrials	15.12	53.97	+290.0	+224.9
Public Utilities	16.04	43.23	+169.8	+124.3
Fire Insurance	13.05	34.30	+162.8	+118.9
New York City Bks.	11.13	24.25	+116.9	+ 80.7
Real Estate				
Selling Price, Typical 1-Family Residence*	\$14,281	\$17,220	+ 21.0	+ 9.8
Farm Real Estate, Dept. of Agriculture Index (1947-49=100)	106	163	+ 53.8	+ 23.1

* Computed from Roy C. Wenzlick & Co., *The Real Estate Analyst*.

It will be seen that, for this particular period, the owner of property or equities in property, has — typically — come out well ahead of holders of cash or fixed income investments.

Thus, the owner of a "typical" one-family residence saw his investment about keep pace with the cost of living. But how many own a "typical" residence? Actually, many homeowners did considerably better, others considerably worse, than is recorded in the table. Investing in housing can be hazardous, involving all sorts of risks — location, neighborhood shifts, changes in style preferences, rent controls (in the case of landlords), to say nothing of the impact of the alternating cycles of ups and down, both in the economy at large and in the building industry itself. And realizing on paper profits can involve a long wait, as well as costs of sale.

Farm land values registered an even larger increase in the period shown — though the rise was not without interruptions. Farm land prices declined in 1949 and again from mid-1952 to the end of 1953. As in the case of homes, "average" farm values can be much different from specific cases.

Buying Common Stocks

As for common stocks, the "average" investment paid off handsomely over the decade. In

actual practice, of course, investors do not buy an "average" stock but a specific issue. Thus "average" gains can be misleading.

Many stocks have declined in value, or have become worthless, even though the general market trend has been upward. At the end of 1958 more than one third of all common stocks listed on the New York Stock Exchange were selling below their highs of 1946, twelve years earlier.

Not only what to buy but when to buy is important. Investors who bought at peak periods in the market have had to be patient indeed. It took 16 of the 30 stocks presently in the Dow-Jones industrial average more than 20 years to get back up to 1929 highs — and four of the stocks still haven't made it. Measured from 1946, 12 stocks took between five and seven years to recapture their '46 high. Two others took more than 12 years and one has not yet regained its '46 peak.

Picking the right stocks at the right time is no simple matter. The increasing popularity of mutual funds (net sales of shares totaled nearly \$1.5 billion last year as against only \$433 million five years earlier) reflects a growing willingness on the part of the investor to pay "load" charges in order to get diversification and expert management. Even so, there are problems of selecting the right fund. The National Association of Investment Companies lists more than 150 mutual fund members.

Five other points need to be noted when considering stocks as an inflation hedge.

First, common stock prices, contrary to popular notion, do not move up in any systematic way with the cost of living. Indeed, stocks have quite often declined at the same time consumer prices were rising. The following table, based on stocks in the Dow-Jones industrial average, gives the record for more than half a century:

Some Common Stock Declines Since 1900 vs. Consumer Price Index

Period	Stock Prices % Chg.	Consumer Prices % Chg.	Interval to Recover Stock Price High
June 1901 to Nov. 1903	—48	+ 6	45 months
Jan. 1906 to Nov. 1907	—49	+ 7	128 "
Nov. 1916 to Dec. 1917	—40	+19	32 "
Nov. 1919 to Aug. 1921	—47	— 4	61 "
Sept. 1929 to Nov. 1929	—48	— 0.4	302 "
Apr. 1930 to July 1932	—56	—20	287 "
Mar. 1937 to Mar. 1938	—49	— 1	105 "
Oct. 1939 to Apr. 1942	—40	+15	63 "
May 1946 to June 1949	—24	+29	47 "
Apr. 1956 to Oct. 1957	—19	+ 5	29 "

Source: November, 1957 *Journal of Insurance* — except for the last two periods which are our own computations.

Second, at recently prevailing price levels, the stocks of many well-known companies are selling at prices which give a current yield of 2½ per cent and even less. Purchases at such prices

can be rationalized by the shrewd investor on a basis of anticipated dividend increases over the years to come. As the following table shows, however, purchases of stock on a yield of 2½ per cent involve either a long period of waiting for a more substantial return, or quite rosy expectations for the future course of dividend payments.

Purchase of Stock Yielding 2½%*						
Assumed Rate of Annual Dividend Increase	Years to Equal Return at Top of Column					
	5%	6%	7%	8%	9%	10%
3%	23½	20¼	18	16½	15¼	14
5%	14½	12	10½	9½	8¾	8
10%	7½	6¼	5½	5	4½	4
15%	5	4¼	4	3½	3¼	3

*Calculations from Moody's Investors Service.

Third, when measuring nominal gains, allowance must be made not only for the general rise in prices hedged against, but also for the capital gains tax.

Fourth, the value of stocks must reflect, in the long run, the earning power of business. This, in turn, will be vitally affected by government programs and policies, taxes, controls and regulations. Rising business profits and dividends do not necessarily follow from higher consumer prices. It is worth noting what happened to common stocks in Great Britain during the years 1946-50 when the Labor Party was in power. During those years—marked by very high taxes, nationalization (and threat of nationalization) of industry, rigid government controls, and basic antagonism towards private business—though the British cost of living rose nearly 22 per cent, prices of industrial shares dropped 17 per cent.

Finally, using common stocks as an inflation hedge would prove futile if everybody tried it. Shifting to equities would develop accelerating advance in their prices to a point where collapse from overvaluation would almost certainly ensue. In eluding inflation, as in fleeing from a burning theater, the greater the number of people who try to crowd through the same exit the smaller the chance for successful escape.

Putting Money in Commodities

As for commodities as an inflation hedge, the warehousing of bulk commodities is not a practical enterprise for most people. Dealings in "futures" markets for cotton, cocoa, wheat, and so forth are pretty much short-term speculative ventures for people not engaged in the particular business, rather than long-term investments. Frequent moves in and out of commodity markets mean commission costs which eat into profits.

Moreover, commodity prices can register violent swings under the influence of war (or threat

of war), weather and crop developments, and changes in government programs and policies. Individually, their movements can be quite independent of the cost of living. It is impossible to anticipate tomorrow's needs for living at today's prices.

The record for 10 commodities in the past decade is shown in the table. Prices of half were lower than 10 years earlier.

Changes in Spot Prices of Basic Commodities
(Dollars Per Unit)

	12/31/48	12/31/58	% Chg.
Cocoa, lb.	\$ 0.30¼	\$ 0.40	+31.1
Copper, lb.	0.29½	0.29	-1.7
Corn, bu.	1.41	1.13	-19.9
Cotton, lb.	0.23	0.24	+4.3
Platinum, oz.	\$1.61	\$2.00	+24.2
Rubber, lb.	0.19	0.21	+10.5
Silver, oz.	0.71¼	0.90	+26.9
Tin, lb.	1.63	0.98	-39.9
Wheat, bu.	2.27	1.98	-12.8
Wool, lb.	1.90	1.10	-42.1

The Sure Way

There is no question but that some people have defended themselves against inflation through shrewd (and sometimes lucky) investments in art treasures, commodities, stocks, or real estate. For the most part, however, such people were skilled in the techniques of the various markets and had capital they could risk.

Not everyone has these opportunities. A person, in good conscience, cannot speculate with funds put aside for family emergencies or for the children's education. And not everyone is financially sophisticated, expert enough to avoid frequent investment pitfalls.

No one can really know what will be the best inflation hedge in the decade to come. What worked in the past 10 years is not necessarily a guide for the future. All that is sure is that the pattern will be different.

What this all adds up to is that for the individual there is no foolproof method of protection against inflation at all times and under all circumstances. And for the community as a whole there is no hedge against inflation. The only way to beat inflation is to prevent it and have money people can trust.

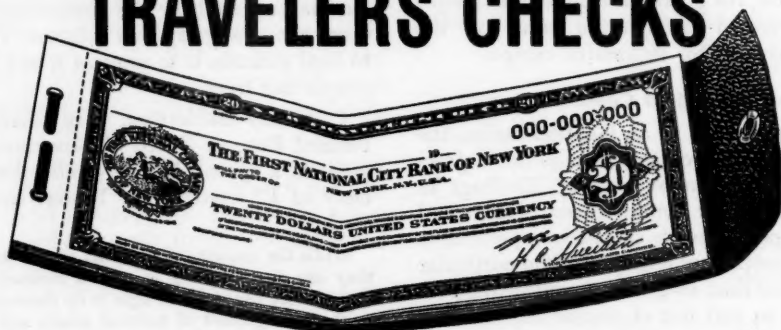
C. Canby Balderston, Vice Chairman of the Federal Reserve Board of Governors, made this point in a speech last November before the Society of Chartered Life Underwriters in Hartford:

While the majority of investors cannot outrun inflation, they can do something to protect themselves against it; that is, they can unite to fight it by demanding prudence in the management of national affairs and by exercising it in the conduct of their own. In short, they can insist that the nation not spend more than it earns through production and that their government live within its income.



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